BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

| | | |
|---|---|---|
| United Illuminating Co. | ) | Docket No. ER92-397-000 |

REQUEST OF THE UNITED STATES
DEPARTMENT OF JUSTICE FOR REHEARING

Pursuant to Rule 713(a)(2)(v) of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (FERC or Commission) (18 CFR § 385.713(a)(2)(v)), the Department of Justice (Department) requests rehearing by the Commission of its July 2, 1992 letter order declining to approve a wholesale power contract between United Illuminating Co. (UI) and UNITIL Power Corp. (UNITIL).1/

Under the contract proposed, UNITIL would have purchased from UI 30 MW of power. The proposed price at which UNITIL would have purchased the power had been determined by market forces, rather than calculated on the basis of principles of cost-based regulation. The July 2 Order inappropriately denied the parties' approval to trade at market-based rates. Despite

1/ Letter to Hunton & Williams, counsel for UI, from Donald J. Gelinas, Director, Division of Applications, dated July 2, 1992 (hereinafter July 2 Order). The Department has filed a Petition to Intervene Out-of-Time in Docket No. ER92-397-000.

the lack of any suggestion that UI might possess market power in any market relevant to this transaction, the Commission refused to approve the parties' contract on the basis of competitive market prices.

The only reason offered for the Commission's action was that UI had not made "known to all potential competitors that [UI] will provide firm transmission of power from within its service territory . . . ." By requiring that UI grant transmission access to potential rivals in order to qualify for market-based rates even where UI has no market power over the purchaser, the Commission erred in this matter.

## I. The UI-UNITIL Proposed Contract Does Not Reflect Any Exercise of Market Power, and the Commission's Rejection of It Is Arbitrary and Capricious

UNITIL Power Corp. operates several small investor-owned utilities with a combined peak demand of 172 MW. UNITIL is directly connected to Public Service Company of New Hampshire (PSNH), with which it has a transmission service agreement allowing it to take delivery of power delivered to PSNH. PSNH, in turn, is connected with several other systems. Transmission in the region is generally available through the New England Power Pool (NEPOOL).2/ As a result of these transmission

---

2/ Application of United Illuminating Co. at n.6.

interconnections, a large number of electric power suppliers can arrange for deliveries to UNITIL.

In 1991 UNITIL sought to contract for 20 MW of long-term base-load capacity beginning in May 1993, increasing to 75 MW by November 1996.3/ On April 17, 1991, UNITIL issued a Request for Proposal (RFP) to over 200 potential sellers. The response to the RFP was profuse--over 80 proposals from 54 companies totalling 2,697 MW from 74 generating units. For deliveries commencing on or before May 1993, there were 42 proposals totalling 1,383 MW. After excluding proposals that were deemed to be too costly or otherwise unattractive, UNITIL evaluated 26 proposals from 12 companies. After further evaluation of the bids and negotiations with the bidders, UNITIL selected 6 proposals from 5 companies totalling 85 MW. Of this, 30 MW were from UI.

### A. Rates Set by Effective Market Forces Are Just and Reasonable and Should Not Be Rejected

The Commission repeatedly has approved market-based rates for bulk power transactions as consistent with its statutory

---

3/ Affidavit of David K. Foote, Vice President for UNITIL Power Company, Application of United Illuminating Company, Attachment 4 (hereinafter, Foote Affidavit).

responsibility.4/ In so doing, FERC correctly has concluded that the market price in a competitive market is just and reasonable, thereby meeting the statutory requirement. In such markets, cost-based regulation is not necessary to assure that rates are just and reasonable. Indeed, the direct and indirect costs of imposing cost-based regulation cannot be justified if markets are competitive.

Rates are lawful under the Federal Power Act if they fall "within a 'zone of reasonableness' where rates are neither 'less than compensatory' nor 'excessive'". Farmer's Union Central Exchange v. FERC, 734 F.2d 1486, 1502 (D.C. Cir. 1984). Clearly a competitive market price falls within this zone. In fact, a competitive market price is at the lower boundary of the zone. The lower bound for rates under the just and reasonable standard is measured by the rate's impact on the utility: "A public utility is entitled to such rates as will permit it to earn a return . . . equal to that generally being made . . . on investments in other business undertakings which are attended by corresponding risks and uncertainties."

---

4/ See, e.g., Entergy Services, Inc., Docket No. ER91-569-000 (March 3, 1992); Commonwealth Atlantic Limited Partnership, 51 FERC ¶ 61,368 (1990); PSI Energy Inc., 51 FERC ¶ 61,367 (1990); Doswell Limited Partnership, 50 FERC ¶ 61,251 (1990); Citizens Power and Light Corp., 48 FERC ¶ 61,261 (1988); Pacific Gas and Electric Co., 44 FERC ¶ 61,010, order on reh'g, 45 FERC ¶ 61,061 (1988), order on compliance, 46 FERC ¶ 61,390 (1989); Pacific Gas and Electric Co., 42 FERC ¶ 61,406, order on reh'g, 43 FERC ¶ 61,403 (1988).

Duquesne Light Co. v. Barasch, 488 U.S. 299, 314-15 (1989) (quoting Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 692-93 (1923)). See also Hope Natural Gas, 320 U.S. 591, 603. This level of return is what results in a competitive industry.5/

The alternative here to market-based pricing is traditional, cost-based rate regulation. This form of regulation is very costly. The costs include substantial direct costs associated with the regulatory process such as record keeping, the burden occasioned by filings with regulatory agencies, and requirements for agency approvals like the one at issue in the instant case.6/ If these costs are

---

5/ Competition limits returns to that level required to attract capital in the face of risks and uncertainty inherent in the endeavor. In this way, under competitive conditions, market-based pricing yields rates at the lower boundary of the lawful "zone of reasonableness." Cost-based rates in contrast, are the result of subjective judgment that the Supreme Court has characterized as "hopelessly complex" and "not [producing] a single correct result." Duquesne Light Co., 488 U.S. at 317. The rates that result may fall anywhere within the zone of reasonableness. Id. Market-based pricing in competitive markets achieves the regulatory goal of keeping rates at their lowest lawful levels more effectively than cost-based regulation. See also Regulation Governing Independent Power Producers, 4 F.E.R.C. Stats. & Regs. ¶ 32,456, at 32,108, 53 Fed. Reg. 9327 (1988) (hereinafter "IPP NOPR"). ("No matter how many improvements may be made to the regulatory structure, cost-of-service regulation is inherently incapable of recreating the ideal, competitive performance.")

6/ For example, the FPA imposes many costly burdens on utilities in the form of advance approvals for activities and reports, and implementing regulations impose additional requirements. 18 C.F.R. §§ 33-35, 41, 45-46, 50, 101 (1991).

unnecessarily imposed on power producers, the result would be to reduce the incentive to invest in generation.7/ By distorting investment decisions, unnecessary cost-based regulation would impair the efficient allocation of resources and raise the cost of electric power to consumers.

Cost-based regulation of wholesale power transactions also can impose significant indirect costs on society. Traditional cost-based regulation may not result in socially efficient prices (as would prevail in an unregulated, competitive market). It therefore may produce distorted price signals,8/ which lead to a misallocation of resources. For example, if regulated prices are too high, the result is underconsumption and inefficient substitution to other products. If, on the other hand, regulated prices are too low, the result is overconsumption and inefficient substitution of resources from other uses. In addition, cost-based regulation reduces the incentive for the minimization of costs in the choice of

---

7/ The Commission in other contexts has recognized this important cost to society. See generally the discussion of investment disincentives in the context of IPPs in IPP NOPR at 32,108.

8/ Price regulation cannot replicate competitive pricing with precision. Thus, no possible improvement in price regulation can completely eliminate this social cost. See also IPP NOPR, at 32,108.

technologies, plant sites, and fuels, and in plant operation. If cost savings do not lead to long-term profit increases, there is less incentive to reduce costs.9/

Unnecessary price regulation also can decrease drastically the freedom of traders to contract in ways that best serve their needs. Reducing this freedom can limit prespecified adjustments to meet foreseeable contingencies as well as prevent renegotiation in response to unforeseen events. Such regulation explicitly precludes certain options, and it creates costly uncertainties because regulators may, even well after the fact as the FERC has here, disapprove of terms of contracts freely entered into. Coping with these indirect regulatory costs leads to additional costs. One inefficiency leads to another as economic agents attempt to avoid or limit the effects of regulation.

For the foregoing reasons, the Commission should eschew traditional, cost of service price regulation, unless there exists a market failure of a magnitude sufficient reasonably to

---

9/ The Commission has noted that "(t)raditional regulation lacks mechanisms that foster long-run efficiency. Utilities reap few explicit rewards for taking risks to aggressively cut their costs, and may face penalties for excessive spending." Notice of Proposed Policy Statement on Incentive Regulation, 58 FERC ¶ 61,287 at 61297.

assure that traditional regulation will yield a net benefit to society.10/

The July 2 Order does not satisfy that standard. Instead, the Order rejects, without explanation, the Commission's stated policy in favor of efficient market-based rates for competitive power over traditional regulation with all its costs. The Order merely made a finding that UI has not "mitigated its market power" for transmission out of UI's 335 square mile service territory, without any examination of the record evidence demonstrating that UI's control of this transmission cannot convey market power over UNITIL in the supply of wholesale electric power. For this reason, the decision in this case to deny the application on the grounds of UI's failure to mitigate transmission market power is entirely without merit.

### B. UI Lacks Market Power To Adversely Affect The Transaction At Issue

The July 2 Order fails to address the uncontroverted evidence in the applications that UI cannot exercise market power with respect to the transaction at issue. The Supreme

---

10/ See Stephen Breyer, Regulation and Its Reform 58-60, 184-88 (1982). See also discussion of the costs of unnecessary regulation in IPP NOPR, at 32,108 ("Traditional cost of service regulation serves the public interest when the protection it bestows exceeds the inefficiencies it creates").

Court has defined market power as "the ability of a single seller to raise price and restrict output." Fortner Enterprises Inc. v. United States Steel Corp., 394 U.S. 495, 583 (1969). The Court has recently reiterated that "[t]he existence of such power ordinarily is inferred from the seller's possession of a predominant share of the market." Kodak v. Image Technical Services Inc., 112 S.Ct. 2072, 2081 (1992). Similarly, the Commission has stated "market power for a seller exists when the seller can significantly influence price in the market by withholding the service and excluding competitors for a significant period of time." Doswell Ltd. Partnership, 50 FERC ¶ 61,210 at 61,757 (1990). Undisputed evidence presented by UI in its application demonstrates that it has no ability to affect the price of bulk power paid by UNITIL.

The competition for the sale to UNITIL was intense. In response to its solicitation for 75 MWs, it received 80 proposals from 54 potential suppliers offering 2,697 MW. The intensity of this bidding competition ordinarily would compel the conclusion that the price accepted was competitive. Thus, the application provides a sufficient basis for the Commission to find that there was adequate competition in generation. The July 2 Order does not reject--or even discuss--UI's assertion

that it lacks market power in generation. Instead, on the facts here attributing market power to UI, which was one of dozens of bidders and which won the right to supply only about 35% of the total quantity purchased, "is so implausible that it cannot be ascribed to a difference in view or the product of agency expertise." Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29, 43 (1983). The use of market-based rates proposed in this application simply may not be rejected on this ground.

### C. There Is No Evidence That UI's Transmission Ownership Adversely Affected the Transaction

The July 2 Order reveals no analysis to support a finding that UI's transmission practices have in any way limited competition for the UNITIL contract. Indeed, the July 2 Order fails to assert that UI has, or even that it may have, market power over UNITIL by virtue of its ownership of a very small transmission system in southwestern Connecticut. There are no rivals here complaining of being barred from UI's transmission system. Nor is there any indication that UI has denied access to its transmission system to a would-be competitor for the UNITIL contract. To the contrary, the record shows that UI has not denied transmission to any competitor that sought it. UI is a small utility with no strategically important transmission. Access to UI's transmission is potentially relevant to only the four Qualifying Facilities (QFs) in its

service area. Three of the QFs sell all of their power to UI and so could not compete to sell to UNITIL.11/ The fourth QF sells outside UI's service area by using transmission access that UI has provided. In short, UI has not used its control over transmission to exclude any competitors.

More importantly, even if the record showed that UI had excluded the four QFs to whom UI transmission access may be relevant from competing to sell to UNITIL, the Order does not explain why exclusion of any of the four QFs would warrant a denial of the application for market-based pricing. The intense competition in the relevant delivered power market assured that the contract price was competitive and thus just and reasonable. Under these circumstances, there is no way that UI's transmission practices could prevent UNITIL from the opportunity to contract at a competitive -- just and reasonable -- price.

The only issue before the Commission is the reasonableness of the proposed UI sale to UNITIL. Not surprisingly, no potential competitor requested transmission from UI at the time

---

11/ UI does not control access for potential new contracts or new plants built by existing competitors. UI's service territory includes only a tiny fraction of the area from which it would be economical to transmit power to UNITIL, and UI's service territory is not especially well suited for a power plant to serve UNITIL. It is not especially close to UNITIL and land there is not especially cheap or available.

UNITIL sought proposals. The availability of UI's transmission for future undefined transactions that may or may not ever be proposed, cannot be relevant to a determination of the reasonableness of this transaction.

The Order gives no explanation of how its finding of UI's "failure to mitigate" market power over its transmission is logically connected to its decision to deny the wholesale power rate contract as unjust and unreasonable. Because the Order sets out no "rational connection between the facts found and the choices made",12/ the Department submits that the July 2 Order cannot withstand review.

## II. No Authority Can Be Cited To Support The Denial To Trade At Competitive Market-Based Rates In This Case

### A. Citation to the Recent Entergy Order Does Not Provide a Reasoned Basis for the Commission's Denial of UI's Application

The Commission's reliance on Entergy Power, Inc., 59 FERC _____ is misplaced. The Entergy Order held that a "decision to allow market-based rates depended upon [the requesting utility's] inability to use control of transmission to block prospective buyers' access to alternative generation sources." Entergy Order at mimeo pp. 5-6. Indeed, the

---

12/ Burlington Trucklines v. United States, 371 U.S. 156, 168 (1962).

Commission's Entergy Order supports approval of UI's application. As demonstrated above, the UI application amply demonstrates that UNITIL had the luxury to pick and choose among an extensive array of sources. Foote Affidavit at p. 3. The July 2 Order does not even mention this evidence. Further, the Entergy Order reiterates the general rule: "A utility does not have to have a system-wide open access tariff on file to show that it lacked transmission market power in a particular transaction." Entergy Order at mimeo p. 7.13/

---

13/ In the Entergy case, the Commission determined, after examining the facts of that transaction, that the buyers did not have sufficient alternatives. The facts examined in the Entergy Order are so different from those presented here that rejection of the proposed rates in that case cannot be a basis for rejection of market-based rates in this transaction. First, Entergy possesses an enormous transmission system with many interconnections, as compared to UI's 335 square mile territory that is completely surrounded by Public Service Corporation of New Hampshire (PSNH). Second, UI won the contract by offering 1 of 5 winning bids out of 80 proposals in response to UNITIL's formal Request for Proposal sent to over 200 utilities. Entergy received its contracts through an informal bidding process involving only a few suppliers. Third, UNITIL had opportunities to purchase power from the many other NEPOOL members that were on equal transmission footing with UI. In contrast, Entergy did not show that other potential suppliers had access to transmission systems comparable to that available to Entergy which would enable them to offer competing bids on the Oglethorpe and Northeast Texas contracts. See Entergy, 59 FERC _____, and the Foote Affidavit.

B. The Commission May Not Inflexibly Require An Open Access Tariff As Quid Pro Quo For Market-Based Rates

The Commission has recognized that "a Commission order requiring wheeling, without more, is impermissible" and that it has no authority to require any utility to wheel power for another entity, with the possible exception of an authority to remedy specific unlawful anticompetitive practice.14/

In the instant matter, there is no finding that UI engaged in any anticompetitive behavior. "[U]nwillingness to transmit for all comers" is not sufficient to demonstrate that an electric utility has acted unlawfully. Associated Gas Distributors v. FERC, 824 F.2d 981, 999 (D.C. Cir. 1987), (construing Richmond Power & Light). Nor does the fact that filing for market-based rates is "voluntary" give the Commission the power to require action of those applying for market-based rates that it could not otherwise require. The Commission lacks general authority to order wheeling in a rate case.15/ The Commission is simply without statutory authority

---

14/ Utah Power & Light, et al., 45 FERC ¶ 61,095 at 61,281, (discussing Florida Power & Light v. FERC, 660 F.2d 668 (5th Cir. 1981) and Richmond Power & Light v. FERC, 574 F.2d 623 (D.C. Cir. 1978) (Richmond Power & Light)).

15/ New York State Electric and Gas Corp. v. FERC, 638 F.2d 388, 393-394 (2nd Cir. 1980)(NYSE&G). Cf. Associated Gas Distributors, 824 F.2d at 1014. (The Commission was found to have no authority to require modification of a lawful rate as a condition to approval of a "voluntary" application for a blanket natural gas certificate. See also Richmond Power and Light, 574 F.2d at 620 ("If Congress had intended that utilities could inadvertently bootstrap themselves into
(Footnote continued on next page.)

to require open access as a quid pro quo for its approval of lawful competitive market-based rates when a purchaser of power has sufficient supply options to assure that it pays just and reasonable prices.

## Conclusion

The Commission's July 2 Order in this case fails to explain its fundamental departure from established precedent. Prices set in a competitive market are just and reasonable. The record evidence in this case supports only one conclusion; that the price in this contract was set by effective competition and thus is just and reasonable. Moreover, there is no evidence that UI's ownership of minimal transmission facilities in any way could or did affect competition for the proposed contract between UI and UNITIL.

In consideration of the uncontradicted evidence that the UNITIL contract was the result of a competitive bidding process

---

(Footnote continued from previous page.)
common-carrier status by filing rates for voluntary service, it would not have bothered to reject mandatory wheeling in favor of a call for just such voluntary wheeling").

and the Commission's established policy that competitive market-based rates are just and reasonable, UI's request for market-based pricing should be granted without additional delay.

Respectfully submitted,


Mark C. Schechter
Chief
Transportation, Energy, and
Agriculture Section

Roger W. Fones
Assistant Chief
Transportation, Energy, and
Agriculture Section

Mary E. Fitzpatrick
Assistant Chief
Economic Regulatory Section

Jade Alice Eaton
Attorney
Transportation, Energy, and
Agriculture Section

Theodore R. Bolema
Attorney
Transportation, Energy, and
Agriculture Section

Antitrust Division
U.S. Department of Justice
Room 9104
555 Fourth Street, N.W.
Washington, D.C. 20001
(202)307-6349

Charles A. James
Acting Assistant Attorney
General
Antitrust Division

J. Mark Gidley
Deputy Assistant Attorney
General
Antitrust Division

Janusz A. Ordover
Deputy Assistant Attorney
General
Antitrust Division


July 31, 1992

CERTIFICATE OF SERVICE

I hereby certify that I have caused to be served a copy of the Request of the United States Department of Justice for Rehearing on each person listed on the Service List for Docket No. ER92-397-000.

Dated in Washington, D.C. this 31st Day of July, 1992.

Jade Alice Eaton
Attorney
United States Department of Justice
Antitrust Division

555 Fourth Street, N.W.
Room 9114
Washington, D.C. 20001
(202) 307-6316